# APPENDIX

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

Case No.: 4-89-01694 N3
Adversary Nos.: 4-90-0247 AN, 4-90-0241 AT

IN RE JOHN MARTIN-MUSUMECI,
*Debtor.*

JOHN MARTIN-MUSUMECI,
*Plaintiff,*

*v.*

HERBERT HAFIF,
*Defendant.*

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Oakland, California
August 30, 1991
3:06 p.m.

**TELEPHONE CONFERENCE**

TRANSCRIPT OF PROCEEDINGS
BEFORE THE
HONORABLE RANDALL J. NEWSOME,
UNITED STATES BANKRUPTCY JUDGE.

APPEARANCE:

| | |
|---|---|
| For the Plaintiff: | EDWARD MENDOZA<br>GENDEL, RASKOFF, SHAPIRO & QUITTNER<br>1801 Century Park East,<br>6th Floor<br>Los Angeles, CA 90067 |
| For the Defendant: | GREG HAFIF<br>LAW OFFICES OF HERBERT HAFIF<br>269 West Bonita Avenue<br>Claremont, CA 91711-4784<br>(714) 624-1671 |
| Court Recorder: | CLAIRE S. TESHIMA<br>U.S. Bankruptcy Court<br>1300 Clay Street<br>Oakland, CA 94612<br>(415) 273-7212 |
| Transcription Service: | KATHLEEN M. REHLING<br>613-B Wescoat Court<br>Mountain View, CA 94043<br>(415) 967-1787 |

Proceedings recorded by electronic sound recording; transcript produced by transaction service.

OAKLAND, CALIFORNIA,
AUGUST 30, 1991, 3:06 P.M.

THE COURT: Hello?

MR. HAFIF: Hello.

MR. MENDOZA: Hello.

THE COURT: Okay. Gentlemen, would you like to identify yourselves, please?

MR. HAFIF: Greg Hafif for the defendant.

MR. MENDOZA: This is Ed Mendoza for John Martin-Musumeci.

THE COURT: Okay. Gentlemen, I'm going to read my decision into the record. I think this is a more expeditious way of doing things than, as I indicated to you at the trial, than trying to send out a written decision. But, obviously, this can be transcribed. And so I'll start.

MR. HAFIF: Thank you.

THE COURT: These adversary proceedings are before the Court pursuant to a trial on the merits held on August the 26th, 1991. As developed at that trial, a number of areas of disagreement exist between the parties, all having to do with a total of four and a half points in the assets held by Micro/Vest as trustee of the Marriner Note Trust.

The first issue concerns a $350,000 loan from the defendant to the debtor, secured by a two percent undivided beneficial interest in the trust. The agreement which the parties signed on July 11, 1984 had a number of co-authors, including the trustee for the defendant, Martin's counsel, Mr. R.M. Bowman, and Martin himself. While not a model of draftsmanship, its key provisions are not ambiguous. It calls for a loan of $350,000 at 16 percent interest, with interest payments of $28,000 in semi-annual installments. The entire principal balance of the loan was to come due on January the 11th, 1985. If the debtor did not pay in full the principal of the loan on that date, then the defendant had a right to convert a portion of the principal into a one-half point beneficial interest.

No schedule is given for principal payments, and no method is given for valuing the one-half beneficial interest. For purposes of this discussion, these flaws in the instrument are irrelevant, since Martin never made any principal payments.

Of prime importance is the alternative remedy provided upon a default in semi-annual interest payments or "to repay the principal when due." In the event the debtor failed to make an interest installment when due, the Plan was entitled to give him 15 days' written demand for payment "or may elect to accelerate payment of the entire balance remaining unpaid." If no payment was made in 15 days, the Plan could sell a portion of the two percent interest to pay off the note. If neither the Plan nor Martin found a buyer within 90 days, then on the 91st day, "full title to said security shall transfer to the holder and shall be deemed full satisfaction of the entire obligation."

Because Martin did not make the January 11th, 1985 interest payment on the note, on March 13th, 1985, the Plan gave Martin his 15-day notice and accelerated the principal balance on the note. While the letter makes reference to the Plan's right of conversion, the reference to the acceleration of the total balance of the principal and of the unpaid interest installment should have put an ordinary, reasonable person on notice that the Plan was opting for its alternative remedy of foreclosure and not the one-half point conversion remedy.

I do not credit Martin's testimony that he reached an oral agreement with Hafif the day after he received the letter, whereby Hafif would only exercise his one-half point conversion right. It is inconceivable to me, especially given the cast of characters and their paper-trail tendencies, that they would leave the disposition of hundreds of thousands of dollars to an oral agreement which was directly contradictory to a written directive.

Despite the fact that Martin completed some $1.4 million in sales of fractional interests in the trust during the week after March 13th, 1985, he never paid a penny on the $350,000 loan. While it is true that the Plan did nothing to line up a buyer, Martin, who now claims that buyers were

readily available — buyers were readily available at the time, did nothing as well, apparently.

On August the 13th, 1985, some 150 or more days after the March 13th notice, the Plan notified Martin that, pursuant to the July 11th, 1984 agreement, title to the note was vested in the Plan. Martin argues that, because the Plan did not follow the dictates of California Commercial Code 9505(2), it did not effectuate a strict foreclosure on the two percent interest securing the note. I disagree, and find that a strict foreclosure was properly effectuated.

Section 9505(2) requires three steps for a strict foreclosure on collateral. One, the secured party must be in possession of the collateral. Two, the secured party must give written notice of its proposal to retain the collateral in satisfaction of the obligation. And, three, the debtor must be given 21 days to object to the foreclosure in writing. See, e.g., *Kruse, Kruse & Miklosko, Inc. v. Beedy*, 20 U.C.C. Reporting Service, 217 at 236, 353 Northeast 2d. 514, 1976, interpreting the 1963 version of the Uniform Commercial Code. See also *White & Summer's Uniform Commerial Code*, 1106, 1978.

Martin asserts that the trust interest is a general intangible, that possession cannot be had of a general intangible, and thus the Plan fails to meet the first requirement of Section 505(2). I agree that the interest in the trust is a general intangible, and would agree that a general intangible cannot be possessed in the usual sense.

Nonetheless, Section 9505(2) does not limit its applicability to certain kinds of collateral. Indeed, the reach of the Commercial Code otherwise extends to both the creation and enforcement of a security interest in general intangibles. It would violate basic principles of statutory construction to read this form of collateral out of Section 9505(2).

Further, I find that while the Plan may not have had actual possession of this collateral, it had sufficient dominion and control over it to constitute "possession" for purposes of this section. While there was no absolute assignment of the two percent, in a letter to Hafif of July 16th, 1984, Micro/Vest itself recognized that Martin had "transferred an interest" in the trust and agreed to "act in accord with writings from your office regarding disposition of said two percent undivided beneficial interest."

This clear acknowledgement by the trustee that the two percent interest was now under the control of a secured creditor is what distinguishes this case from *Sprangers v. Fundamental Business Technology, Inc.*, 4 U.C.C. Rep. Service 2d., 1322, Minnesota Court of Appeals, 1987, a case upon which Martin relies upon, wherein a third party bank refused to give control of the collateral to the creditor — to the creditor. It's also what makes it closer on the facts to *Kruse, Kruse & Miklosko, Inc. v. Beedy*, supra, at 236, where the court held that:

> "Possession of collateral by a bailee who has received notification of the interest of a secured party is considered to be possession by the secured party."

See also *Copeland v. Stewart*, 52 Cal. App. 3rd, 217, 124 Cal. Reporter 860, 867-868, 1975. See also *White & Summer's* at 937.

Martin next asserts that the August 13th, 1985 letter did not "propose" to keep the collateral as required by 9505(2), but instead presented strict foreclosure as an accomplished fact. While the letter does state that the foreclosure is final, "with title vested in the pension plan," the fact remained that, thereafter, Martin did nothing to protect the loss of the two percent. His halfhearted assertion that he felt it was too late is not credible, particularly in light of defendant's August 25th letter which left the door open for Martin to

repurchase the two percent for the principal and interest owing. Had he sent a written objection within the 21-day period prescribed by the statute, he might now be in a position to assert his rights under Section 9504. Having failed to object, he lost that right, and the foreclosure became valid.

Parenthetically, it should be noted that the present version of the statute, unlike the 1963 version of 9505(2), does not require the creditor to inform the debtor of his right to object to the foreclosure. Even if the August 13th, 1985 letter was not in the nature of a proposal, I find that the March 13th, 1985 letter can be fairly read as being one. Consistent with their agreement, Martin was given 90 days to find a buyer of the two percent. During that time, he must surely have been aware of the fact that the Plan was doing nothing to sell the note, and probably intended to keep it. He neither found a buyer, nor paid off the note, nor protested the impending foreclosure called for under the agreement. If the Plan had, in fact, irrevocably foreclosed on the two percent prior to the August 13th letter, it was certainly within its right to do so under Section 9505(2).

Accordingly, I conclude that ownership of the two percent lawfully resides in the Plan pursuant to a properly executed strict foreclosure.

The question of value of the points is now mooted by this conclusion. Nonetheless, I credit the valuation testimony presented by Martin over that presented by the Plan. Points had been sold to an investment banker for some $750,000 each only four months prior to August of 1985. Regardless of whether this price makes sense given the underlying values of Computerland or IMS, it is still the best indicator of fair market value in these circumstances.

Putting aside Hafif's gloomy picture of ComputerLand's future, the fact is that his own pension plan priced these

points in its August 25, 1985 letter at a low of $500,000 in late 1985 to a high of $1.7 million in late 1986. The fact that, subsequent to that time, new light was shed on ComputerLand's fortunes is simply irrelevant.

Accordingly, I find that the points were worth $700,000 on August the 13th, 1985.

The next issue concerns the parties' rights to dividends under the July 11, 1984 loan agreement and the October 10, 1984 agreement to purchase two and a half points for $500,000. The October 10 agreement is quite clear on this point. Martin is entitled to all dividends that accrued prior to October 1, 1984, and the Plan is entitled to all dividends accruing after that date. Martin's uncontroverted testimony is that no dividends accrued after October 1, 1984. Thus, I find he's entitled to all of the dividends derived from that two and a half percent interest.

A significant dispute arose as to the appropriate amount of the dividends to which he is entitled. Without going into great mathematical detail, I find that two and a half percent, rather than the one and a quarter percent asserted by the Plan, is the correct starting point in the calculation, and that 4,331 shares is the most accurate amount for dividends that accrued to Martin.

A contrary conclusion must be reached as to the two percent loan agreement. That agreement says that Martin will retain the right to receive accrued dividends "until such date upon which any portion is sold under foreclosure." Giving the words their plain meaning, this language merely restates a right which is already provided for in Commercial Code 9306. In other words, the right to be paid any proceeds from the collateral would remain with Martin until foreclosure, at which point it would pass to the Plan. If Martin intended to retain the right to receive dividends, he certainly

knew how to say so, as is obvious from the October 10 agreement.

Accordingly, I conclude that the right to be paid any accrued dividends on the two percent passed to the Plan upon foreclosure.

The final issue concerns Martin's right to reimbursement for advances of attorneys' fees paid pursuant to the Marriner Note Trust. Martin admits that he has already received stock from Micro/Vest as reimbursement for these advances. However, he claims that he is entitled to put this stock to the Plan and receive back some $51,744.02 in cash. He admits that neither the two percent loan agreement nor the two and a half percent purchase agreement confer this right on him. The loan agreement merely states that "the legal payment obligations" shall pass to the Plan upon foreclosure. The purchase agreement says that the Plan will be responsible for reimbursement of expenses after October 1, 1984.

Martin asserts that fairness requires that he be allowed to put the stock to the Plan for cash, because the stock he received from Micro/Vest was assigned an agreed-upon value of $17.00 but is now only worth $10.00 to $13.00. No support other than his own testimony is given for these values. Putting that aside, had Hafif been paid in cash as reimbursement for costs he expended in obtaining a verdict in the trust's favor, I might be inclined to agree with Martin. But if fairness is the standard, then I find it only fair that Martin be paid in the same currency as Hafif: Computerland stock.

This conclusion obviates the need for determining the amount of reimbursement Martin actually paid on the four and a half points after they vested in Hafif — in the Plan; excuse me. I would note, however, that Martin's evidence on this point does not meet his burden of proof. Based on the

dates of the checks he submitted, it appears that only $178,920.00 were paid after August the 13th, 1985. .1467 of that amount comes to $26,247.56.

Further, it is not clear whether the post-August the 13th, 1985 payments for fees were for fees that accrued after that date or were simply late payments for fees that accrued pior to that time.

At any rate, I conclude that Martin is not entitled to put any of the stock he received as fee reimbursement to the Plan.

For the reasons stated, judgment will be entered accordingly on the causes of action that have been stated in the complaint. It is so ordered.

Gentlemen, is there anything else? Do you have any questions.

MR. HAFIF: Well, I guess maybe we'll just have to work out how the stock will transfer to Martin versus an appeal, but I guess that'll be between Mr. Mendoza and myself.

THE COURT: Okay.

MR. MENDOZA: Your Honor, one other aspect of this thing is the possibility of future distributions by Micro/Vest. This is a claim for declaratory relief. Can we have a declaration as to future dividend rights on the October 10th agreement?

THE COURT: As stated, my understanding of the October 10th agreement is that there weren't any dividends that accrued prior to — after October 1 of 1984.

MR. MENDOZA: Okay. I understand.

THE COURT: I have no evidence of anything else.

MR. MENDOZA: All right.

THE COURT: Okay?

MR. MENDOZA: Yes.

THE COURT: All right. We'll put on a judgment entry, but as to the findings of fact and conclusions of law, the foregoing constitutes my findings of fact and conclusions of law under Rule 52. And if you want a copy of them, you can order a copy of this transcript. Otherwise, I'm going to put on a judgment entry that's consistent with these findings.

MR. HAFIF: I don't have any problem with that, Your Honor.

THE COURT: Okay.

MR. MENDOZA: All right. Thank you, Your Honor.

THE COURT: Thank you, gentlemen. Bye.

MR. MENDOZA: Good-bye.

(Telephone conference proceedings concluded at approximately 3:21 p.m.)

## CERTIFICATE

I certify that the foregoing is a correct transcript from the electronic sound recording of the proceedings in the above-entitled matter.

KATHLEEN M. REHLING _____

Kathleen M. Rehling, Transcriber Date

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
Case No. C 92-0494 BAC

In re

JOHN MARTIN-MUSUMECI, et al.,

*Debtor.*

JOHN MARTIN-MUSUMECI, et al.,

*Appellant,*

vs.

LAW OFFICES OF HERBERT HAFIF PENSION AND PROFIT SHARING PLAN,

*Appellee.*

**ORDER**

## I. FACTS AND BACKGROUND

On July 11, 1984, Appellee made a loan to the Debtor in the amount of $350,000 at 16% interest, with interest payments of $28,000 in semi-annual installments. The first installment was due on January 11, 1985. Debtor executed a note in favor of Appellee, secured by a two percent interest of the undivided beneficial interest in the Marriner Note Trust (the "Trust"). Debtor was one of the drafters of the loan agreement.

The Note provided that in the event Debtor failed to make any interest installment payments when due, Appellee may, within 90 days of making a written demand for payment, sell the two percent interest in the Trust ("2 Points"). The Note also provided that if the 2 Points were not sold within the 90 day period, then ". . . full title to said security shall transfer to the Holder [Appellee] and shall be deemed full satisfaction of the entire obligation; I

[Debtor] shall not be liable for any real or alleged deficiency." As an alternative remedy, the Note provided that the Appellee had the right to convert one-half of one percent of the interest in the Trust as repayment.

Because Debtor failed to make the Jan. 11, 1985 interest payment on the note, by letter dated March 13th, 1985, pursuant to the terms and conditions of the Note, Appellee gave Debtor 15-day notice and accelerated the principal balance on the note. The letter referred to Appellee's right to conversion; however, the letter specifically stated that Appellee would not exercise that right. The Bankruptcy court held that the letter should have put Appellant on notice that Appellee was opting for the foreclosure option.

Debtor failed to respond to the March 13th letter. On August 13, 1985, five months later, Appellee sent Debtor another letter stating that pursuant to the terms of the agreement, Appellee had foreclosed on the Note. The letter specifically noted that Debtor's involvement in litigation precluded Appellee from selling the security because it would expose the plan participants to liability. As Debtor had failed to secure a buyer, Appellee was forced to foreclose. The letter specifically left open the possibility of Debtor's repurchasing the securities from Appellee.

On August 25, 1985 Appellee sent another letter to Debtor again offering Debtor an out. While expressly stating that Appellee owned the 2 Points, the letter gave Debtor an additional 60 days to buy back the 2 Points for the principal and interest due to date. The letter made further provisions for buying back the 2 Points at later dates for higher prices. Debtor failed to respond to this last offer.

Appellee did not hear from Debtor again about the loans until five years later. In 1988 Debtor filed for bankruptcy. In 1990, five years after the foreclosure, Debtor filed suit against Appellee alleging that the foreclosure had violated

Cal. Commerical Code § 9504(3).[1] After a trial before the Bankruptcy Court, the court found that the foreclosure complied with the requirements of § 9595(2).[2]

## II. STANDARD OF APPELLATE REVIEW

The Bankruptcy Court's findings of fact are reviewed under the clearly erroneous standard, and the Bankruptcy Court's conclusions of law are reviewed *de novo. See, In the Matter of Pizza of Hawaii, Inc.,* 761 F.2d 1374, 1377 (9th Cir. 1985). Appellant maintains that this appeal concerns solely questions of law. However, Appellee properly argues that the issue of whether or not appellant was given proper notice of Appellee's intent to strictly foreclose is a question of fact which should be reviewed under the clearly erroneous standard. The other issues presented by this appeal are to be reviewed *de novo.*

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[1]Debtor maintains that Appellee should have foreclosed under Cal. Commercial Code § 9504(3) instead of § 9505(2) because § 9504 does not have a possession requirement.

[2]Section 9505(2) provides that:

> In any other case involving consumer goods or any other collateral *a secured party in possession* may, after default, propose to retain the collateral in satisfaction of the obligation. Written notice of such proposal shall be sent to the debtor if he has not signed after default a statement renouncing or modifying his rights under this subdivision. In the case of consumer goods no other notice need be given. In other cases notice shall be sent to any other secured party from whom the secured party has received (before sending his notice to the debtor or before the debtor's renunciation of his rights) written notice of a claim of an interest in the collateral. If the secured party received abjection in writing from a person entitled to receive notification within 21 days after the notice was sent, the secured party must dispose of the collateral under Section 9504. In the absence of such written objection the secured party may retain the collateral in satisfaction of the debtor's obligation. (Emphasis added.)

## III. DISCUSSION

Under § 9505(2), the secured party has available to it the remedy of "strict foreclosure" in the event Debtor fails to make payments on the debt. "Strict foreclosure" allows the secured party to retain the collateral in full satisfaction of the debt. Section 9505(2) requires: (i) a default, (ii) the secured party to be in possession of the collateral, (iii) in cases not involving consumer goods, the secured party must send written notice to the debtor (in some cases other secured parties) that it proposes to retain the collateral in full satisfaction of the debt, and (iv) that the debtor or any other party entitled to notice be given twenty-one days after the proposal to object.

There is no dispute that Debtor defaulted. Debtor, however, seeks to overturn the bankruptcy court's ruling on two grounds. First, Debtor maintains that as the two percent interest in the trust fund is a general intangible asset which cannot be possessed, § 9505 does not apply. Second, assuming that § 9505(2) applies, Debtor argues that the bankruptcy court erred in finding that Appellee gave Debtor written notice of foreclosure as required by § 9505(2)

### A. Possession of Collateral

Debtor maintains that as the trust property is a general intangible, Appellee could not have possession over it as required before § 9505(2) applies. This argument must fail for two reasons, both articulated by the bankruptcy court. First, § 9505(2) does not limit its application to certain kinds of collateral. There is nothing in either §§ 9505(2) or 9504, or the comments to those sections, which specifically limits the application of § 9505(2) as Debtor suggests.

Debtor argues that by definition, Appellee cannot be in possession of a general intangible as defined in § 9-106 of the U.C.C. Debtor cites to the comments of U.C.C. § 9-305 for this proposition. However, the comments to that section

only state that a security interest in a general intangible, ordinarily not represented by a writing, can only be perfected by a writing. (Comment 1). Debtor cites to no authority which states that a secured creditor of a general intangible interest cannot avail itself of the rights contained in § 9505(2).

Second, the bankruptcy judge found that while Appellee may not have been in actual possession of the collateral, it had sufficient dominion and control over it to constitute "possession" for purposes of § 9505(2). This holding was based on a finding that the trustee to the trust acknowledged Appellee's control over the two percent interest in a letter to Appellee dated July 16, 1984, in which the trustee recognized that Debtor had "transferred an interest" in the trust and agreed to "act in accordance with writings from your office regarding disposition of said two percent undivided beneficial interests."

*The Law of Secured Transactions Under the Uniform Commercial Code*, 2d Ed., Section 4.10[3], pp. 159-160, states:

> "For another case that implies that retention and satisfaction of the debt is permissible even when the collateral is intangible, such as accounts receivable, see *In re Emergency Beacon Corp.* The clear implication from the case is that strict foreclosure would be available as an option for the accounts assignee."

In *In re Emergency Beacon Corp.*, 441 U.C.C. Rep. 1544 (JD N.Y. 1985), 48 B.R. 341, the Debtor received a loan from the Creditor that was secured in part by Debtor's accounts receivable, a general intangible. To satisfy the debt, Debtor turned over to Creditor its accounts receivable. The court specifically held that Creditor acquired possession of the accounts receivable. *Id.* at 346. Here Debtor attempts to distinguish *In re Emergency Beacon Corp.* by arguing that

the court did not address the question of whether an intangible could be possessed for purposes of § 9505(2). However, the primary importance of *In re Emergency Beacon Corp.* is its holding that a secured creditor can strictly foreclose on a general intangible.

Once it is determined that Appellee had sufficient possession of the collateral for purposes of § 9505(2), it must be determined whether Appellee gave Debtor sufficient notice.

B. Sufficiency of Notice

Debtor argues that he was never given notice of Appellee's intention to exercise the "strict foreclosure" option. Debtor argues that the August 13, 1985 letter did not "propose" to keep the collateral as required by §9505(2). Instead, the letter indicated that Appellee had already foreclosed, and thus made objection fruitless. The bankruptcy court found, first, that Debtor's assertions that he could not object were not credible, especially in light of the August 25 letter which specifically gave him a right to pay off the note. Second, the court found that the March 13th letter was sufficient notice of a proposal to foreclose.

The bankruptcy court's finding on the notice issue presents questions of fact which are reviewed under the clearly erroneous standard. Here, the March 13th letter clearly gave notice that Debtor was in default. Additionally, as the bankruptcy court found, the letter indicated that Appellee did not wish to exercise its right to conversion. The court found that this letter was sufficient notice. The fact that Debtor did nothing to address this issue, despite repeated requests, further supports the bankruptcy court's findings.

## CONCLUSION

For the foregoing reasons, the bankruptcy court's order is AFFIRMED.

IT IS SO ORDERED.

Date: 7/30/92

BARBARA A. CAULFIELD

BARBARA A. CAULFIELD
United States District Judge

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 92-16528

D.C. No. C-92-494-BAC

Bankr. No. 4-89-01694 N3
(Chapter 11)

In re

JOHN MARTIN-MUSUMECI, etc.,

*Debtor.*

JOHN MARTIN-MUSUMECI, etc.,

*Plaintiff-Appellant,*

v.

LAW OFFICES OF HERBERT HAFIF
PENSION AND PROFIT SHARING PLAN,

*Defendant-Appellee.*

**MEMORANDUM***

Appeal from the United States District Court
For the Northern District of California
Barbara A. Caulfield, District Judge, Presiding

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*This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by Ninth Cir. R. 36-3.

Argued and submitted January 13, 1994
San Francisco, California

BEFORE: SCHROEDER, NOONAN, Circuit Judges, and JONES,** District Judge

## INTRODUCTION

Appellant, a Chapter 11 debtor, alleges that his attorney's pension plan, which loaned appellant money, did not have the right to strictly foreclose on the two percent interest in a trust the plan held as security for the loan. Appellant alleges that the plan was incapable of possessing the trust interest, a general intangible, and as such could not effect a strict foreclosure.

Although as a rule a general intangible such as a trust interest cannot be possessed, we affirm the district court because based on this unique set of facts we find the plan was in possession of the collateral and could strictly foreclose when appellant defaulted.

## FACTS AND PROCEEDINGS

The loan at the heart of this case was made on July 11, 1984 by attorney Herbert Hafif to his then-client, John Martin-Musumeci ("debtor"), who eventually filed for bankruptcy. The $350,000 loan came from funds held by the Herbert Hafif Pension and Profit Sharing Plan ("the plan").

Debtor executed a note in favor of the plan secured by a two percent interest of the undivided beneficial interest in the Marriner Note Trust ("the trust"), also known as the Micro/Vest trust. According to appellee, Micro/Vest was a corporation with assets of a single note which on its face

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**The Honorable Robert E. Jones, United States District Judge, District of Oregon, sitting by designation.

gave the holder the right to convert the outstanding balance of the note into 20 percent of the shares of Computerland stock. The note executed by debtor (not to be confused with the note Micro/Vest owned) provided that in the event debtor failed to make any interest installment payments when due, the plan may, within 90 days of making a written demand for payment, sell the two percent interest in the trust ("the two points"). The note also provided that if the two points were not sold within the 90 days period, then:

> full title to said security shall transfer to the holder [the plan] and shall be deemed full satisfaction of the entire obligation; I [debtor] shall not be liable for any real or alleged deficiency.

The note provided that Hafif had the right to convert one-half of one percent of the interest in the trust as repayment as an alternate remedy.

Debtor failed to make the January 11, 1985 interest payment. By letter dated March 13, 1985, Hafif's office, on behalf of the plan, gave debtor 15 days' notice and accelerated the principal balance on the note. This notice letter also said, "We certainly do not wish to exercise our right of conversion." When debtor failed to respond, Hafif's office sent debtor another letter dated August 13, 1985, stating that pursuant to the terms of the agreement, the plan had foreclosed on the note. This letter noted:

> [T]his is not a security we can sell. This is especially true in light of the lawsuits against Microvest [sic]. We can not subject the pension plan participants to exposure to multi-million dollar lawsuits over the sale of the security.
>
> Furthermore, since your efforts to sell the security have been unavailing, efforts which we appreciate have been made more difficult by the lawsuits, and since we owe

> the utmost fiduciary duty to our plan's participants, the plan has foreclosed on the security.

Hafif's office also told debtor that should he wish to repurchase the two points, the plan would "seriously consider any good faith, reasonable and fair offer."

Debtor received a third letter from the plan on August 25, 1985 notifying him that, while the plan was now the full owner of the two points, he had an additional 60 days to buy back any portion of the two points for the principal amount. The letter contained additional provisions for buying back the two points later for more money. Debtor did not respond to this last offer.

Three years later debtor filed for bankruptcy. In 1990, five years after the plan had foreclosed on the two points, debtor filed suit in bankruptcy court against the plan alleging that the foreclosure violated California Commercial Code Section 9-504(3), which covers the sale of collateral after a default. Following trial, the bankruptcy court found that the plan had complied with the provisions of California Commercial Code Section 9-505(2), which provides that a secured party in possession can strictly foreclose if notice has been given and there is no objection within a 21-day period.[1]

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[1]This section reads:

> In any case involving consumer goods or any other collateral a secured party in possession may, after default propose to retain the collateral in satisfaction of the obligation. Written notice of such proposal shall be sent to the debtor if he has not signed after default a statement renouncing or modifying his rights under this subdivision. In the case of consumer goods no other notice need be given. In other cases notice shall be sent to any other secured party from whom the secured party has received (before sending his notice to the debtor or before the debtor's renunciation of his rights) written notice of a claim of an interest in the collateral. If the secured party receives objection in writing from a person entitled to receive notification within 21 days after the notice was sent, the secured party must dispose of the collateral under Section 9504. In the

Debtor unsuccessfully moved to alter judgment and then appealed to the district court, which affirmed the judgment of the bankruptcy court on July 30, 1992.

## STANDARD OF APPELLATE REVIEW

Because this panel is in as good a position as the district court to review the bankruptcy court's findings, we independently review the bankruptcy court's decision. *Matter of Pizza of Hawaii, Inc.*, 761 F.2d 1374, 1377 (9th Cir. 1985). We review the bankruptcy court's findings of fact under the clearly erroneous standard; conclusions of law are reviewed *de novo. Id.*

Whether or not the points were capable of possession and whether the plan did in fact possess them are questions of law we review *de novo.* Whether or not notice was given is a factual determination, *In re Professional Inv. Properties of America*, 955 F.2d 623, 626 (9th Cir. 1992), *cert. denied*, 113 S.Ct. 63 (1992); thus, we review the notice issue for indication that the district court's ruling was clearly erroneous.

## DISCUSSION

Section 9-505(2) "presents an uncomplicated blueprint for strict foreclosure on default." 2 White & Summers, *Uniform Commercial Code* 586 (3rd ed. 1988) (hereinafter "White & Summers"). The California code section, like its UCC counterpart, provides the secured party the remedy of strict foreclosure in the event the debtor defaults, a remedy that allows the secured party to retain the collateral in full satisfaction of the debt. In order to meet the requirements of a strict foreclosure under Section 9-505(2), there must be (1) a default; (2) a secured party in possession of the

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absence of such written objection the secured party may retain the collateral in satisfaction of the debtor's obligation.
Cal. Com. Code Section 9-505(2).

collateral; (3) written notice sent to the debtor by the secured party that the secured party proposes to retain the collateral in full satisfaction of the debtor; and (4) a period of 21 days during which time the debtor may object to the proposed retention of the collateral. White & Summers at 586-87.

Because debtor never made any payments on the loan, there is clearly a default. Debtor, then, seeks to overturn the district court's decision on three grounds: (1) the interest in the trust is a general intangible that cannot be possessed and thus Section 9505(2) does not apply; however, if Section 9-505 does apply, (2) the plan did not give adequate notice of its proposal to retain the collateral in satisfaction of the debt as required by Section 9-505(2); and (3) debtor gave proper notice of his objection to the plan's retention of the collateral as required by Section 9-505(2).

1. *Was the trust interest, as a general intangible, incapable of possession?*

Appellant is correct in his assertion that as a general rule, a general intangible cannot be possessed.

> Since the creditor's possession (and the debtor's lack of it) is designed to put third parties on notice, the collateral must be the type that one can see, touch, and move. The collateral must have a physical embodiment recognizable as exclusively representing the right. Thus it follows that accounts and general intangibles cannot be perfected by possession.

White & Summers at 348. No perfection of general intangibles by possession is possible because general intangibles, by their nature, cannot be possessed.

However, under these limited circumstances and only for purposes of Section 9-505 applicability, we find that the plan was in possession of the two points in the trust by virtue of a

letter from the treasurer of Micro/Vest to Hafif as the plan representative. That letter reads, in pertinent part:

> As Treasurer of Micro/Vest Corporation, I am authorized to verify the existence and relative size of various beneficial interests and the identities of the holders. . .
>
> This is to verify and acknowledge that Micro/Vest Corporation, as trutee (sic), has been advised and recognizes that Mr. John Martin-Musumeci has transferred an interest to you equal to two percent (out of 100%) of the full undivided beneficial interest in the trust, which interest is to be held by you as security for a promissory note made by Mr. Martin-Musumeci. I acknowledge that Mr. Martin-Musumeci has the authority and ownership necessary to make such transfer valid. I further agree that this corporation shall act in accord with writings from your office regarding disposition of said 2% undivided beneficial interest.[2]

This letter, dated July 16, 1984, has the effect of giving the plan the status of a secured party in possession of collateral, which in turn qualified the plan to effect a strict foreclosure pursuant to § 9505(2). As one court explained:

> Thus, the possession of collateral by a bailee who has received notification of the interest of a secured party is considered to be possession by the secured party.

*Kruse, Kruse & Miklosko v. Beedy,* 353 N.E. 2nd 514, 539 (Ind. App. 1976) ("*Kruse*"). This ruling was cited approvingly in 9 Anderson, *Uniform Commercial Code* 801 (3rd ed. 1985):

> A secured party is in possession of the collateral for the purposes of UCC § 9-505 while the collateral is in the

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[2]The letter also explains that Micro/Vest Corporation is the plaintiff in litigation to enforce conversion of the note into capital stock.

possession of an escrow who knew of the security interest at the inception of the escrow arrangement.

Based on the letter from the Micro/Vest treasurer, who was acting as a bailee and had notice of the plan's interest, we find that the plan was in possession of the two points for purposes of § 9-505(2) and could proceed under that statute.

2. *Did the plan give adequate notice of its proposal to retain the collateral?*

The bankrutpcy court found that the March 13, 1985 letter served as notice that the plan was proposing to keep the collateral in satisfaction of the debt. This letter specifically indicates that the plan is giving "notice pursuant to the terms and conditions of the note." Pursuant to the agreement, debtor was given 90 days to find a buyer for the two percent. The bankruptcy court found that debtor "neither found a buyer, nor paid off the note, nor protested the impending foreclosure called for in the agreement."

The plan again warned debtor about foreclosure in the August 13, 1985 letter and in a third letter dated August 25, 1985. In this latter correspondence, the plan gave debtor 60 days to buy back the two points, which the bankruptcy court found made debtor's assertion that he thought it was too late to object to the foreclosure not credible.

The bankruptcy judge's determination that notice was given was not clearly erroneous. Furthermore, even if we review *de novo* reasonableness of notice as a matter of law, as debtor urges, we find the three letters sent to debtor over a six-month period constituted notice that the plan was proposing strict foreclosure. Although the letters of August 13 and 25 present the forelcosure as a *fait accompli,* both letters also give debtor a repurchase option. In fact, the letter of August 25 gives debtor 60 days to buy back the two points, which exceeds the statutory requirement of 21 days

for the debtor to file objections. Still the plan heard nothing from debtor.

We find that debtor received notice regarding the plan's proposal to strictly foreclose.

3. *Did debtor give proper notice of his objection?*

Debtor maintains that if the literal requirements of "possession" and "written proposal" are to be read out of § 9-505(2), then the court should find that a reference to debtor's objection in Hafif's August 25, 1985 letter "complies with the spirit" of § 9-505(2)'s requirement that objections be filed in writing. This argument is without merit. The statute explicitly requires written objections, which debtor failed to make.

We find debtor failed to give proper notice of his objection.

CONCLUSION

The judgment of the district court is AFFIRMED.

*In re John Martin-Musmeci*, No. 92-16528

NOONAN, Circuit Judge, dissenting:

As the disposition of the court acknowledges, a general intangible cannot be possessed. As possession was necessary under California law for foreclosure, no foreclosure occurred. I would reverse.